

Message Text

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ORIGIN SS-10

INFO OCT-01 ISO-00 /011 R

66619

DRAFTED BY EA:PDELVECCHIO/SB

APPROVED BY EA:MR HELBLE

S/S:PKJOHNSON

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R 190337Z NOV 74

FM SECSTATE WASHDC

TO CINCPAC HONOLULU HI

S E C R E T STATE 254597

EXDIS

MILITARY COMMANDS HANDLE AS SPECAT EXCLUSIVE

CINCPAC ALSO PASS TO POLAD

THE FOLLOWING IS A REPEAT OF PHNOM PENH 15336

ACTION SECSTATE 16 NOVEMBER 1974. QUOTE:

S E C R E T PHNOM PENH 15336

EXDIS

E.O. 11652: GDS

TAGS: EGEN, CB

SUBJECT: ECONOMIC ASSESSMENT AT THE END OF THE WET SEASON

1. WITH THE CLOSE OF THE 1974 WET SEASON AND AS WE LOOK AHEAD TO THE UPCOMING DRY SEASON, IT IS CLEAR THAT THE ECONOMIC SITUATION CONTINUES TO BE GRIM. WHILE THERE HAS BEEN RELATIVELY LITTLE CHANGE IN THE MILITARY BALANCE DURING THE PAST WET SEASON, THE ECONOMIC SITUATION INCREASINGLY REFLECTS THE CUMULATIVE IMPACT OF THE WAR AND THE KHMER GOVERNMENT'S APPROACH TO ECONOMIC POLICY.

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2. IN SOME SIGNIFICANT WAYS THE SITUATION IS BETTER THAN IT

WAS EARLY IN 1974. IN FEBRUARY OF THIS YEAR, WHEN PHNOM PENH WAS SURROUNDED AND UNDER DIRECT ATTACK, THE KHMER REPUBLIC HAD ITS BACK AGAINST THE WALL. ITS CAPITAL CITY WAS BUT OFF, THE LAND IMMEDIATELY SURROUNDING THE CITY WAS ABANDONED BY FARMERS WHO HAD FLED, AND ABOVE ALL THE OVERLAND LINK TO THE ONLY SURPLUS REMAINING PROVINCES WAS CLOSED BY THE ENEMY. AS A RESULT, WITH THE SUPPLY OF TRADITIONAL COMMODITIES SUDDENLY COMPLETELY CUT OFF, PRICES SKYROCKETED. THE ANNUAL RATE OF INFLATION IN MARCH WAS PROBABLY IN THE RANGE OF 320 PERCENT PER YEAR.

3. MANY MEASURES, MILITARY AND ECONOMIC, WERE TAKEN BOTH BY US AND BY THE KHMERS. THE PERIMETER AROUND PHNOM PENH WAS EXPANDED AND THE LAND LINK WITH THE WESTERN PROVINCES OPENED VIA THE TONLE SAP RIVER AND ROUTE 5. NEW TRANSPORTATION ASSETS WERE PROVIDED UNDER THE AID PROGRAM TO MOVE CRITICAL DOMESTIC COMMODITIES INTO PHNOM PENH. A QUICK IMPACT PRODUCTION PROGRAM WAS INITIATED TO TRY AND INCREASE THE SUPPLY OF CERTAIN COMMODITIES, PARTICULARLY FISH AND MEAT. THESE EFFORTS HAVE HAD SOME SUCCESS, AND THE RATE OF INFLATION INSTEAD OF FURTHER ACCELERATING HAS SLACKED OFF A BIT. WE ESTIMATE THAT THE PRESENT RATE OF INFLATION, ON AN ANNUALIZED BASIS, IS ABOUT 80 PERCENT.

4. NEVERTHELESS THE UNDERLYING ECONOMIC SITUATION IS MOST PRECAIRIOUS. HYPERINFLATION, ONCE BEGUN, IS HARD TO STOP AND THE PRICE INCREASES THAT HAVE OCCURED ARE INVIETABLY A PERMANENT PART OF THE KHMER SCENE. CONSEQUENTLY ADJUSTMENTS IN GOVERNMENT CONTROLLED PRICES, SUCH AS FOR PL 480 RICE, FOR FOREIGN EXCHANGE, AND FOR IMPORTED PETROLEUM PRODUCTS ALL NEEDED TO BE MADE TO CORRECT THE IMBALANCE WHICH THE HYPERINFLATION HAD BROUGHT ABOUT. THIS WAS DONE IN SEPTEMBER WHEN THE FOREIGN EXCHANGE RATE, PL 480 RICE AND PETROLEUM PRICES WERE ALL TRIPLED. IT WAS HOPED THAT THESE MEASURES WOULD REDUCE MONETARY EXPANSION, MODERATE THE INCREASES IN OTHER PRICES, HELP INCREASE AGRICULTURAL PRODUCTION, AND REDUCE THE PRESSURES OF THE EXCHANGE MARKET. THESE MEASURES, WHILE SEVERE, WERE ABSOLUTELY ESSENTIAL FOR THE SURVIVAL OF THE KHMER REPUBLIC'S ECONOMY. BUT THEY WILL NOT, BY THEMSELVES, BRING ABOUT IMPROVEMENT IN THE ECONOMIC SITUATION.

5. THIS IS BECAUSE OF TWO SETS OF CONDITIONS:

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A) THE GOVERNMENT'S LOSS OF TERRITORY, THE SHIFT OF 25 PERCENT OF THE POPULATION UNDER GOVERNMENT CONTROL FROM BEING PRODUCERS TO BEING REFUGEES, ABANDONMENT OF HUNDREDS OF THOUSANDS OF ACRES OF RICELAND, THE CLOSING OF MAJOR ARTERIES OF SUPPLY HAS AN EVER DEEPENING ECONOMIC EFFECT.

B) IN THE LAST FEW YEARS THE GOVERNMENT HAS INCREASED ITS BUDGETARY EXPENDITURES IN AN ATTEMPT TO FINANCE THE WAR AND

MEET ITS ENLARGING CIVIL AND MILITARY PAYROLL. HOWEVER, SINCE IT IS DOING THIS IN THE FACE OF RAPIDLY SHRINKING RESOURCE AS TERRITORY WAS LOST, THE RESULT HAS BEEN MORE MONEY CASHING FEWER GOODS. NOT ONLY DID THIS LEAD TO THE PRESENT HYPER-INFLATION BUT PERHAPS MORE IMPORTANTLY, THE GOVERNMENT'S PRACTICES HAVE ALSO LED TO A FURTHER DECLINE IN THE LEVEL OF PRODUCTION. THIS HAS BEEN IN NO SMALL DEGREE A RESULT OF FOLLOWING POLICIES OF MAINTAINING LOW FIXED EXCHANGE RATES, LOW CONSUMER PRICES FOR RICE AND OTHER PRODUCTS WHILE AT THE SAME TIME EXPANDING THE BUDGET IN A PERIOD OF RAPIDLY RISING PRICES.

6. REVIEWING THE ECONOMIC SITUATION AT THIS TIME IT IS CLEAR THAT THE DIFFICULTIES FACING US AND THE KHMER GOVERNMENT ARE ENORMOUS. WHILE AT THE MOMENT THE ECONOMIC SCENE IS RELATIVELY TRANQUIL, CERTAINLY MORE SO THAN EARLY THIS YEAR, IT IS EXCEPTIONALLY DIFFICULT TO COME TO ACCURATE JUDGEMENT AS TO WHAT THE STATE OF THE ECONOMY WILL BE DURING THE NEXT SIX MONTHS.

7. ONE ASPECT WHICH MAKES FORECASTING ESPECIALLY HAZARDOUS IS THAT THE ECONOMIC VIABILITY OF THE KHMER REPUBLIC IN 1975 DEPENDS, MUCH MORE SO THAN IN PREVIOUS YEARS, ON THE SUPPORT OF FOREIGN AID AND ALSO ON THE DEGREE OF DISCIPLINE WHICH THE GOVERNMENT INTRODUCES INTO THE MANAGEMENT OF ITS BUDGET.

8. WE ARE CONFIDENT THAT WE CAN CONTINUE TO KEEP PHNOM PENH AND OTHER FOOD-DEFICIT AREAS SUPPLIED WITH RICE EVEN THOUGH THE AMOUNT REQUIRED UNDER PL 480 (325,000 TONS NEXT YEAR) IS SUBSTANTIAL. WE ALSO BELIEVE THAT SOME PROGRESS CAN BE ACHIEVED IN OUR JOINT EFFORTS TO AUGMENT SOMEWHAT THE SUPPLY OF DOMESTIC COMMODITIES IN PHNOM PENH ALTHOUGH THIS DEPENDS OVERWHELMINGLY ON STABILITY OF THE MILITARY SITUATION. WE ARE LESS
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CERTAIN AS TO WHETHER THE REQUISITE DISCIPLINE CAN BE BROUGHT TO BEAR ON BOTH MILITARY AND CIVIL AUTHORITIES TO CONTAIN THE EXCESSES INHERENT IN THE PRESENT FINANCIAL AFFAIRS OF THE GOVERNMENT. IF THIS LATTER PROBLEM CAN BE BROUGHT UNDER CONTROL, AND IF, OF COURSE, THE MILITARY SITUATION REMAINS RELATIVELY STABLE, THE KHMER ECONOMY CAN SURVIVE YET ANOTHER SIX MONTHS. HOWEVER, WITHOUT SIGNIFICANT PROGRESS IN SOLVING THIS PROBLEM, THE GREAT AND ULTIMATE CRISIS OF THE KHMER ECONOMY IS APT TO COME UPON US DURING 1975, AND PROBABLY EARLIER IN THE YEAR RATHER THAN LATER.
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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC STABILITY, ECONOMIC DATA, POLITICAL SITUATION
Control Number: n/a
Copy: SINGLE
Draft Date: 19 NOV 1974
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CollinP0
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974STATE254597
Document Source: CORE
Document Unique ID: 00
Drafter: PDELVECCHIO/SB
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D740333-0757
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741131/aaaaazlp.tel
Line Count: 167
Locator: TEXT ON-LINE, ON MICROFILM
Office: ORIGIN SS
Original Classification: SECRET
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators:
Previous Classification: SECRET
Previous Handling Restrictions: EXDIS
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: CollinP0
Review Comment: n/a
Review Content Flags:
Review Date: 29 JUL 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <29 JUL 2002 by cunninfx>; APPROVED <18 MAR 2003 by CollinP0>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC ASSESSMENT AT THE END OF THE WET SEASON
TAGS: EGEN, CB
To: CINCPAC
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005